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SIPDIS

STATE PLEASE PASS AIT/W AND USTR

STATE FOR EAP/RSP/TC, EAP/EP AND EB/IFD/OIA

USTR FOR SCOTT KI

USDOC FOR 4420/USFCS/OCEA/EAP/LDROKER
USDOC FOR 3132/USFCS/OIO/EAP/ADAVENPORT
TREASURY FOR OASIA/ZELIKOW AND WISNER
TREASURY PLEASE PASS TO OCC/AMCMAHON
TREASURY ALSO PASS TO FEDERAL RESERVE/BOARD OF
GOVERNORS, AND SAN FRANCISCO FRB/TERESA CURRAN

E.O. 12958: N/A

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SUBJECT: Economic Briefing for March 2005

Introduction and Summary

1. This cable summarizes selected recent economic events in Taiwan in March 2005:

- Taiwan's economic performance in Q1 of 2005
- Privatization of two large state-owned enterprises
- Legal-regulatory workshop for export control
- High-Speed Rail Continues Efforts to Raise Capital
- Taiwan reaction to China's Anti-session Law

END INTRODUCTION AND SUMMARY.

Economic Slowdown Continues Through Q1

2. A leading indicator compiled by Taiwan's Council for Economic Planning and Development (CEPD) for February 2005 showed a decline of 1.3% (compared to the previous month), signaling continuation of the economic slowdown from 2004 to Q1 of 2005. Export growth declined steadily from well over 20% in the first half of 2004 to 8% in the first two months of 2005. Industrial production declined in January-February 2005 and the unemployment rate posted its first increase in seven months. The manufacturing facility utilization rate in February 2005 fell to 77%, the lowest in the past two years. Profits dropped to 4.6% of sales, the lowest in the past one and a half years. Higher import prices of crude oil and other materials brought inflationary pressure, prompting Taiwan's Central Bank of China to raise interest rates in late March 2005.

3. In spite of the economic slowdown, Taiwan businesses are optimistic. According to a survey conducted by the Taiwan Institute of Economic Research (TIER) in March 2005, 55% of respondents expected better business performance in the next six months, compared to 8.5% anticipating worse performance. Major local economic think tanks expect that public construction projects and incentives for emerging industries could help Taiwan's economy in the second half of 2005. Foreign bankers, however, forecast that Taiwan's investment expansion and economic growth in 2005 will slow significantly because of higher interest rates will dampen consumption in the United States, an important export market.

Privatization - Chunghwa Telecom Company

4. In early March 2005, Premier Frank Hsieh instructed the Ministry of Transportation and Communications (MOTC) to sell 17% of government equity in the Chunghwa Telecom Company (CTC) by mid-2005. CTC is the largest telecom firm on the island, with 84% of Taiwan's telecom market. The CTC sale, the island's largest secondary share offering ever, would reduce government ownership from 64.89% to 47.89%, making CTC a private firm according to Taiwan's definition of "state-ownership." CTC labor unions have opposed privatization and may try to block the planned sale.

Privatization - Changhwa Commercial Bank

5. On March 18, two foreign consortia bid on Changhwa Commercial Bank (CCB), slated to become the first Taiwan state-owned bank sold to foreign investors. The CCB will award 1.4 billion Global Depository Receipt (GDR) shares,

equivalent to 22% equity, to the high bidder. The GDR bid winner will then be permitted to purchase another 18% ownership stake in CCB directly from the government. This will enable the winning bidder to have effective control with a 40% equity stake. The sale of CCB will meet the Taiwan's financial reform goal of selling at least one state-owned bank to foreign investors before the end of 2005. However, in a sign of possible problems in the CCB sale, Treasury Department Director General Liu Deng-cheng announced on March 22 that the government would not approve the sale if bids were far below the market price. Several days later, CCB Vice President Hsieh Chao-nan denied the press reports and noted that the government and bidders were still negotiating on the CCB sale.

Praise for Workshop on Export Controls

16. Several Taiwan officials have praised the recent four-day Legal-Regulatory Workshop sponsored by the State Department NP/ECC/EXBS program in Taipei March 22-25. They noted that the training "made real" concepts they had heard, but did not fully understand. They also noted that the Workshop brought together Taiwan government officials from essentially all Taiwan ministries and agencies involved in export controls and gave them a chance to share perspectives. The workshop featured active participation by the attendees, particularly those from the Board of Foreign Trade (BOFT), National Security Council, Customs Service, and Science Park Administration. In the wrap-up session, BOFT announced a near-term, mid-term, and long-term work agenda that included remedying several specific defects in Taiwan's current export control laws and implementation procedures identified during the seminar.

High-Speed Rail Announces 11th Revision of Financial Plan

17. After failing to meet the fund raising requirements of its financial plan for the tenth time, the Taiwan High-Speed Rail Corporation (THSRC) revised its plan for raising capital again at a stockholders meeting on March 4. The plan calls for THSRC to raise NT\$ 13.5 billion (about USD 420 million) by the end of May by issuing preferred stock. The plan calls for THSRC to raise the first NT\$ 6 billion (about USD 190 million) by the end of March. THSRC and the Ministry of Transportation and Communications have also called on the Legislative Yuan to permit additional investment by state-owned enterprises (SOEs) in THSRC. SOE investment now stands at about 16 percent of THSRC's total capital. On March 9, MOTC reaffirmed that the high-speed rail will open on time on October 31, 2005.

Hsieh Reiterates "Active Opening, Effective Management" Policy

18. Two days after hundreds of thousands took to the streets of Taipei to express opposition to China's Anti-secession law, Premier Frank Hsieh assured Taiwan's Legislative Yuan that the current Taiwan policy of "actively opening (investment in China) with effective management" remains unchanged. He assured that the government would not go back to the "patience without haste" era. He noted that the government will relax laws (for cross-Strait economic exchanges) but will enforce them strictly. With the government's policies unchanged, a mission organized by Taiwan's Chinese National Federation of Industries (CNFI) to visit China and CNFI Chairman Earl Ho's planned meeting with Taiwan business people in China will proceed in June 2005 as scheduled. Local observers believed that higher interest rates in the United States had more to do with the recent NTD depreciation and stock price decline than the recent cross-Strait events.

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